



# **Kentucky Retirement Systems**

**The Division of Internal Audit (IA)**

**Procedures Manual**

**Effective Date: November 19, 2015**

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## Internal Audit

### 1) KRS Goals and Internal Audit activities

<b>KRS Mission</b>	<b>Internal Audit Mission</b>
Kentucky Retirement Systems (KRS) serves by building the strength of the trust funds to ensure that adequate resources are available to meet the systems' current and future obligations while helping members and beneficiaries achieve financial security in retirement by efficiently and effectively administering the benefit programs established by the Kentucky General Assembly.	The mission of the Division of Internal Audit (IA) is to enhance and protect organizational value by providing risk based and objective assurance, advice, and insight.
<b>KRS Goals</b>	<b>Internal Audit Activities to support this goal</b>
1. Leadership by Cost Effectiveness Management, Benchmarking, and Comparisons.	The activities to support this goal include reviewing and appraising the adequacy and effectiveness of the system of internal control; reviewing the means of safeguarding assets; and, appraising the economy, efficiency and effectiveness with which resources are employed.
2. Best Membership Service.	The activities to support this goal include reviewing and ensuring compliance with policies, procedures, plans, and regulations; reviewing operations and ensuring it is consistent with KRS' established objectives and goals; and, assessing the adequacy of established systems and procedures.
3. Fiduciary and Financial Responsibility.	The activities to support this goal include assuring the reasonableness of financial statements; relevance, reliability and integrity of management; financial and operating data and reports; and, conducting special assignments and investigations on behalf of the Board of Trustees and Executive Management.

## **2) Introduction**

### **➤ Mission**

The mission of the Division of Internal Audit (IA) is to enhance and protect organizational value by providing risk based and objective assurance, advice, and insight.

### **➤ Core Principles of Internal Audit**

- Demonstrates Integrity.
- Demonstrates competence and due professional care.
- Is objective and free from undue influence (independent).
- Aligns with the strategies, objectives, and risks of the organization.
- Is appropriately positioned and adequately resourced.
- Demonstrates quality and continuous improvement.
- Communicates effectively.
- Provides risk-based assurance.
- Is insightful, proactive, and future-focused.
- Promotes organizational improvement.

### **➤ Purpose and Activities**

The Internal Audit function was established to assist the Executive Director and Executive Management of Kentucky Retirement Systems (KRS) to attest to its governance role and achieve sound managerial control over all aspects of the operations of KRS including accounting, provision of benefits, asset management, information management and control systems, and for such other activities for which they are responsible. The overall objective of the Division of Internal Audit is to assist all levels of management in the effective discharge of their responsibilities by providing independent analysis, appraisals, advice, counsel and recommendations concerning the activities reviewed. In carrying out duties and responsibilities, the Division of Internal Audit will have full, free, and unrestricted access to all agency activities, records, property, and personnel.

The Division seeks to identify risks, evaluate controls, and make recommendations that will strengthen the operations of KRS. The Division of Internal Audit helps to improve the performance and accountability of KRS by assessing the reliability of financial and operating information; evaluating the efficiency and effectiveness of other Divisions; testing the adequacy of controls for preventing waste

and safeguarding assets; verifying compliance with policies, procedures, and regulations; and, advising and providing KRS employees ways to increase internal control knowledge, awareness, and assessment capabilities, promotes continuous improvement; making appropriate recommendations for improving the governance process; and, assures reasonableness of the financial statements. In addition, Internal Audit promotes ethics and values within KRS; communicates risk control information to appropriate areas of KRS; and, coordinates activities with the Audit Committee, Board of Trustees, Executive Management, and the External Auditor, if necessary.

➤ **Independence, Objectivity, and Ethics**

The Audit function is a staff and advisory function reporting directly to the Audit Committee and the Board of Trustees, and administratively to the Executive Director. The Internal Audit Director is therefore considered to be independent of the KRS operations being reviewed.

Objectivity is essential to the audit function. Therefore, the Internal Audit Director should not devise or install procedures that will be later reviewed. The Internal Audit Director's objectivity will not be compromised by reviewing and recommending controls for new systems. In the installation of new systems, the Internal Audit Director can offer suggestions for minimum controls during the course of feasibility studies and program implementation without impairing objectivity.

The Internal Audit Director shall maintain high standards of conduct, honor and character so that credibility and integrity are not open to question. The Internal Audit Director will subscribe to the [Codes of Professional Ethics](#) and [Standards](#) as promulgated by the [Institute of Internal Auditors](#) (IIA), and [KRS Personnel Policies](#) and [Kentucky Executive Branch Code of Ethics](#).

➤ **Internal Audit Charter**

The [Internal Audit Charter](#) establishes the authority and responsibility conferred by the Executive Director and/or Audit Committee of the Board of Trustees of KRS on the Division of Internal Audit. The Charter is reviewed annually and approved by the Audit Committee and the Board.

➤ **Audit Committee Charter**

The [Audit Committee Charter](#) establishes the authority and responsibility of the Audit Committee of the Board of trustees of KRS. It is approved by the Audit Committee and the Board.

➤ **Internal Audit Budget**

The Audit Committee approves a biennial budget for the Internal Audit Division based on the audit plan, outside resources, and technology needs. The Internal Audit Director prepares the budget for the Audit Committee's approval. The Board of Trustees ratifies the Internal Audit budget. The Internal Audit Director provides an actual to budget report to the Audit Committee at the quarterly Audit Committee meetings. The Audit Committee Biennial Budget should be presented to the KRS Chief Operations Officer for inclusion in the KRS Biennial Budget Request.

➤ **Job Descriptions**

The Division of Internal Audit was established in July 2003. A new position [Internal Auditor](#) was created and filled. In April 2005, two new positions were created: [Internal Auditor I](#) and [Internal Auditor II](#). The Internal Auditor I position was filled in April 2005. In January 2009 the Internal Auditor I was promoted to the Internal Auditor II position. The Internal Auditor I position was left vacant. In October 2009, the Investment Compliance Officer position was placed in the Internal Audit Division, and reports to the Internal Audit Director. In December of 2010, the Internal Auditor's title was changed to Director of Internal Audit.

## Organizational Chart

➤ **Internal Audit Staff and Responsibilities**

Ms. Connie A. Davis, CIA, CGAP, CRMA

Internal Audit Director

Responsibilities: Oversees the creation and assessment of compliance audits with financial, operational and IT controls in accordance with the Board of Trustees and management specifications. Ensures policies, programs and procedures are in place to achieve strategic and operational objectives. Reporting to Executive Director and Audit Committee, responsibilities include performing operational, financial and system audits in support of KRS internal audit plan, evaluation of adequacy and effectiveness of internal controls, assessment of governmental and regulatory compliance and recommending improvements to mitigate risks, improve controls and regulatory/governmental compliance. Modifies accounting systems by

noting problems, revising procedures and recommending and implementing new methods; analyzes accounting systems and identifies proper accounting controls; suggests or installs new controls or modifies current controls.

Ms. Samantha A. Payne

Internal Auditor II

Responsibilities: Audits the activities and functions of various internal operations to insure proper internal controls and compliance with internal policies and procedures and governmental policies and procedures. Plans and conducts compliance, operational, and financial audits, completes special project requests as assigned and assists the Internal Audit Director. Adequately documents all test work, prepares work papers, and drafts written reports for each assignment. Communicates audit results to the Internal Audit Director. Prepares drafts of summary memorandum accurately describing results of tests performed, the nature of control weaknesses and exposures, and identifies practical recommendations for improvement.

Ms. Erica W. Bradley,

Investments Compliance Officer

Responsibilities: Performs daily, monthly, and annual reviews of purchases, sales, income transactions, portfolio composition, cash management and other investment related activities. Audits the activities and various functions of investment operations, as directed by the audit plan and requested by management, to insure proper internal controls and compliance with internal policies and procedures. Documents all test preformed, prepares work papers, and drafts written reports for each assignment. Communicate audit results to the Internal Audit Director, the Investment Staff, the Investment Committee, and the Audit Committee.

### **3) Internal Audit Services**

The Internal Audit Division provides independent auditing and consulting services to assist management in balancing operational efficiency with risk identification, assessment, and control. IA reports to the Audit Committee and the Board of Trustees and collaborates with management to enhance assurance and accountability at all levels of KRS. In order to meet the responsibilities and objectives as set forth in the Audit Charter, it is necessary for the Division of Internal Audit to perform reviews and audits of varying types and scopes depending on the circumstances and requests from management. Each fiscal year an Annual Audit Plan is developed and submitted to the Audit Committee and the Board of Trustees for review and

approval. The audit plan is based on a risk assessment methodology, as well as requests from management and the Audit Committee. Audit services can be requested by employees of KRS. The following types of audit services are provided by the Division of Internal Audit.

*a. Financial Audits*

A financial audit is a review intended to serve as a basis for expressing an opinion regarding the fairness, consistency, and conformity of financial information with generally accepted accounting principles. Financial audits can be full or limited in scope depending on the objectives. A full scope financial audit consists of a review of the financial statements of an entity of sufficient extent to express an opinion on those statements. Such an audit is conducted in accordance with generally accepted auditing standards as adopted by the American Institute of Certified Public Accountants (AICPA).

Prior to presentation to the Audit Committee, the Internal Audit Director will review the Annual Independent Audit Report, Management’s Discussion and Analysis, Financial Statements, and footnotes, and discuss with Executive Management and the External Auditor any perceived errors and discrepancies. However, Executive Management, not the Internal Audit Director, is responsible for the substantive content, accuracy, consistency, and completeness of Management’s Discussion and Analysis, Financial Statements and footnotes.

Financial audits are more limited in scope and concentrate on a review of the financial transactions and adequacy of: 1) physical control over assets, 2) system of authorization and approval, 3) separation of duties between operations and custody of assets. The primary concerns are determining accuracy of data and evaluation of controls.

*b. Compliance Audits*

Compliance audits determine whether the division has complied with statutory regulations, KRS policies and procedures, departmental policies and procedures, [Kentucky Administrative Regulations](#) and [Kentucky Revised Statutes](#).

*c. Operational Audits*

Operational audits are concerned with the effectiveness and efficiency of operational units to attain organizational and departmental objectives. Effectiveness measures how successfully an organization achieves its goals and objectives. Efficiency measures how well an entity uses its resources to achieve its goals.

*d. Special Audits*

Special audits include but are not limited to:

1) Information Technology Audits

Audits of information systems and technology may be performed to determine whether existing or new computer applications and hardware functions in an accurate and efficient manner, and include adequate internal controls. Audit involvement in a new system may include the review of system development methodology and the effectiveness and efficiency of the system being implemented. These audits could include reviews of general controls which affect all computer applications. Examples include computer security, disaster recovery, program change controls and quality control procedures.

2) Investigative Audits

Investigative audits may result from findings during a routine audit or from information received from personnel. These audits are normally requested by management, Board of Trustees, and/or anonymous tips and focus on alleged, irregular conduct. Reasons for investigative audits include: internal theft, misuse of State property, and/or conflicts of interest. The audit should be conducted immediately, collecting as much evidence as possible. It is essential that the records in question be removed from the department/employee under investigation or otherwise safeguarded. Investigative audits will be conducted in accordance with the Internal Audit procedures, and may include expertise from internal and external experts in fields, such as but not limited to, legal, information technology, human resources, accounting, and audit.

The draft investigative audit report will be provided to the Audit Committee. The Audit Committee will determine if further actions are needed. The Audit Committee will determine the distribution of the report internally and externally.

3) Management Audits

A management audit assesses the quality of the decision-making process and the information environment. They may be requested by the senior officers, Board of Trustees, or the need becomes apparent because of the number of findings within a department on other types of audits.

4) Performance Audits

These are audits that provide an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. Performance audits include, but are not limited

to, reviews of departmental procedures and operations to determine whether:

- (a) The duties and responsibilities are being performed in the most efficient and economical (cost effective) manner;
- (b) Activities are properly authorized by the management;
- (c) The management system has the capacity to ensure compliance with applicable laws, regulations, contracts and policies; and
- (d) Operations actually conform in all material respects to applicable laws, government regulations and standards, contracts, policies and industry standards.

#### 5) External Audit Assistance

Assistance may be provided to the [External Auditor](#) and/or the [State Auditor](#) during the annual audit of the financial statements. The Internal Audit Director will work with the external auditors to foster a cooperative working relationship; reduce the incidence of duplication of effort; ensure appropriate sharing of information; and, ensure coordination of the overall audit effort. The Internal Audit Director will make available to the external auditors all internal audit working papers, programs, flowcharts, and reports. The Internal Audit Director annually will review the resulting management letter comments to determine if there is any impact upon the annual internal audit plan.

#### 6) Referencing

During the course of various types of audits, the auditor may determine some "themes" are recurring. When performing audits, you may note the same problem for different departments. These may be findings for two departments within a division which indicate a division finding; i.e., too little control, need for increased communication, no performance criteria, data processing policy needed, etc. When compiling annual reports on the Audit Department results, IA always considers these themes in scheduling audits for the next period-particularly when these items support the KRS mission.

## **4) Internal Audit Practices**

### ➤ **Conflicts of Interest**

Internal Auditors should be objective in performing their job. Objectivity requires Internal Auditors to have an impartial and unbiased attitude, to avoid conflicts of interest, and to perform audits in such a manner that no significant quality compromises are made. Therefore, the department will do its best to make sure the auditors are not placed in situations in which they feel unable to make objective, professional judgments.

- Each auditor will be required to complete an annual [Conflict of Interest Statement](#) certifying that auditors' have no actual or perceived conflict that would impair their objectivity or independence. Statement should have supervisory sign off.
- Staff assignments will be made so that potential and actual conflicts of interest and bias are avoided. If a conflict of interest or bias is present, the auditor(s) will be reassigned.
- Staff assignments will be rotated periodically, if practicable to do so.
- Internal Auditors will not assume operating responsibilities.
- Internal Auditors should refrain from assessing specific operations for which they were previously responsible.

➤ **Due Professional Care**

Internal Auditors should apply the care and skill expected of a reasonably prudent and competent auditor. Due professional care does not imply infallibility. The Internal Auditor should exercise due professional care by considering the:

- extent of work needed to achieve the engagement's objectives;
- relative complexity, materiality, or significance of matters to which assurance procedures are applied;
- adequacy and effectiveness of risk management, control, and governance processes;
- probability of significant errors, irregularities, or noncompliance;
- cost of assurance in relation to potential benefits; and,
- Computer Assisted Audit Tools (CAATS) including basic software packages such as Excel, Access, Word, and Interactive Data Evaluation and Analysis (IDEA) audit Software during the audit.

➤ **Proficiency and Continuous Professional Education (CPE)**

Auditors should collectively possess the knowledge, skills, and other competencies essential to the practice of internal auditing within the organization. Educational and work experience criteria have been established for the various positions within the division. In order to maintain their proficiency, all auditors are encouraged to continue their education and will be given adequate opportunities to do so. Such continuing education ensures that Internal Auditors remain current on professional techniques and standards. Continuing education hours are also necessary to meet certification requirements. Professional

certification should be obtained. Accreditation is an important indicator of an auditor's technical proficiency. Certification as a Public Accountant, Internal Auditor, or Information Systems Auditor is encouraged for all departmental personnel and is a requirement for certain positions. If no certification requirements are necessary, a minimum of 16 hours should be obtained. Continuing education may be obtained through membership and participation in professional societies, attendance at conferences, college courses, and in-house Training.

In addition, members of the [Institute of Internal Auditors](#), [The American Institute of CPAs](#) and/or the [Kentucky Institute of CPAs](#) must meet the requirements of those organizations. KRS may cover the cost of obtaining continuing education; however, the employee should obtain approval prior to registering for any course or seminar.

➤ **Performance Evaluations**

As outlined in the [KRS Personnel Policies](#), employees shall be subject to a formal evaluation. Employees are to receive a formal [Performance and Planning Review](#) (PPR) on semi-annual and annual basis, usually during the month of February and September. Each Internal Auditor should prepare and complete an annual PPR document, in conjunction with his/her supervisor. Additionally, each auditor shall receive feedback at the conclusion of each audit. This feedback may be written or oral. The Audit Committee Chair, Vice Chair, and Executive Director review the performance of the Director of Internal Audit, and the Internal Audit Director reviews staff's performance.

➤ **Quality Assessment Review (External)**

The Division of Internal Audit commenced in July 2003. Due to its small size (three staff members), Internal Audit conducted a "Self-Assessment with Independent (External) Validation" (Practice Advisory 1312-2) during fiscal 2014. The Division of Internal Audit strives to ensure the Internal Audit function is compliant with the International IIA Standards. Accordingly, the Internal Audit Division has had its second review (Self-Assessment with Independent External Validation). The second quality assurance review was completed by the Louisville Chapter of the Institute of Internal Auditors approved validators, The Internal Auditor for the Louisville and Jefferson County Metropolitan Sewer District and a Staff Internal Auditor for Fruit of the Loom on January 3, 2014. The [Quality Assurance Report](#) was finalized at the Audit Committee meeting on February 6, 2014. The

next Quality Assessment Review will be conducted in fiscal 2018, as required by the Professional Practices Framework.

➤ **Internal Assessment (Ongoing and Periodic)**

Ongoing internal assessments represent routine Internal Audit activities. Ongoing internal assessments are an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. The measurement tools for assessment are engagement supervision; [Self-Assessment Quality Control Checklist](#) for each audit; feedback from audit customers; [Service Quality Factors and Measures–Annual](#); audit plan completion; and, analysis of other performance metrics such as recommendations accepted. Conclusions should be developed as to the quality of ongoing performance, and follow-up action should be taken to assure appropriate improvements are implemented.

Periodic assessments represent non-routine, special-purpose reviews and compliance testing annually. Periodic Assessments may be completed by audit professionals such as Certified Internal Auditor (CIA) and within a short time prior to an external assessment. The measurement tools are to assess compliance with the [Internal Audit Activity’s Charter](#); [The IIA Standards](#); the [Code of Ethics](#); the efficiency and effectiveness of the activity; more in depth interviews; Self-Assessment (QAR-IIA) Tools; Post - Audit Client Survey, [Service Quality Factors and Measures–Annual](#); and, benchmarking of the Internal Audit activity’s practices and performance metrics against relevant best practices of the Internal Auditing profession. The Director of Internal Audit should share the results of periodic assessments, necessary plans, and their successful implementation with appropriate persons outside the activity, such as senior management, the Audit Committee, and the Board of Trustees on a regular basis.

➤ **Records Retention and Disposition**

Internal Audit shall retain for seven (7) years a complete file of each audit report and each report of other examinations, investigations, surveys and reviews made under its authority in accordance with the KRS records retention policy or [Kentucky Department for Libraries and Archives \(KDLA\)](#). The file should include audit work papers and other supportive material directly pertaining to the report. To guard against identity theft and fraud, destruction of business records and materials should be done in a secured manner such as Cintas Box should be used, all CD/DVD materials should be disposed in Cintas Box or they

should be submitted to Information Security Officer.

## **5) Internal Audit Procedures**

### **➤ Risk Assessment Process**

The Audit Plan is based on a risk assessment methodology, as well as requests from management. Internal Audit activities are accomplished by identifying individual division audits and interviewing division heads and other personnel. In addition, research and prior audit experience assist in the management of enterprise risk. Once the risk areas of a division are identified, each is weighted according to the significance to the overall division's mission and objective.

The Risk Assessment Methodology is based upon the following six-part process:

- developing the risk assessment model;
- identifying KRS division activities;
- scoring risks using impact and probability factors and weights;
- ranking the auditable areas;
- developing the audit plan; and,
- submitting the audit plan for management review and approval.

The [Risk Assessment Model](#) is based upon both impact and probability risk factors. Impact evaluates the effect resulting from a break down in the operation's environment, processes, and/or controls. Probability looks at the likelihood that an event will occur. Impact is broken down into five (5) evaluation factors and probability contains three (3) evaluation factors. Each factor is given a weight based on its importance in evaluating the overall risk of a process. The following are the evaluation factors for both impact and probability:

#### **Impact**

1. Level of authority involved
2. Volume of transactions
3. Materiality
4. Regulatory Involvement
5. Internal Environment

#### **Probability**

1. Complexity of systems
2. Management and control environment
3. Internal Control System

Each impact and probability factor is then separately evaluated and assigned a point level (1-5) with one representing the lowest level of risk and five the highest. The individual factor scores are then multiplied by the risk weight factor. The weighted risk factor elements are added together to obtain the respective total impact and probability score for each division. After ranking, the audit plan is developed for the highest risk areas.

➤ **Annual Audit Plan**

Based upon the risk assessment model, Internal Audit develops the [Annual Audit Plan](#) by scheduling audits for the highest risk areas. The Plan is to establish an audit universe representing potential audits. Internal Audit also recognizes other potential audit segments such as business processes, expense contracts, and functional areas that may cross over operational units.

The Annual Audit Plan is submitted to the Audit Committee of the Board of Trustees for approval. Internal Audit also presents the Risk Assessment Model and Annual Audit Plan to Executive Management for review, and obtains their suggestions/concerns or priorities. The Plan is periodically reviewed, evaluated, and modified (i.e., objectives, goals, and strategies) according to the specific risk factors related to KRS' operations, internal controls, and estimated liability to the Commonwealth of Kentucky. Staff is assigned to audits based upon an auditor's background/experience and Annual Audit Plan.

The staff tracks [Audit Reports Summary Index](#). It includes engagements in-process, date of issuance, recommendations made, response due date, response received date, follow – up date, audits which are scheduled to roll forward to the following Plan year, and performs audits or analyses (not foreseen during risk-assessment/planning) which are requested by Executive Management during the fiscal year.

➤ **Audit Procedures**

Complete the [Self-Assessment Quality Control Checklist](#) throughout the audit engagement process.

**a) Planning Phase:**

- Prepare Work Index File (Year-File#) with Audit Index, Audit Report, Auditee's Response, Administration, and Fieldwork
- Establish audit objectives and scope.
- Send audit clients an email notifying them of the audit including the scope of the audit.
- Conduct Pre-audit research or review previous reports.

- Perform preliminary survey and identify risks and internal controls.
- Entrance conference with auditee, and document results.
- Develop Audit program with scope, risks, and the nature and extent of testing required to achieve the objectives of the engagement, post fieldwork activities such as quality assurance and report issuance.
- Obtain approval from supervisor.
- Document planning phase results in Administration File.

**b) Fieldwork Phase:**

- Prepare Flowchart or narrative based upon planning phase results.
- Perform actual Fieldwork, use CAAT and IDEA audit Software, if applicable, and other audit techniques for sampling/testing.
- Verify that each step in the audit program has been performed.
- Verify that necessary work papers are adequately indexed, initialed, cross-referenced and dated.
- Schedule and hold the exit conference to confirm findings and recommendation(s), and document the results.
- Verify that the last date of fieldwork is noted on the audit program and the audit report.
- Document all valid and reasonable testing/sampling, conclusions, findings, and recommendations, evidence, work papers, and exit conference in Fieldwork File.
- Review work papers by supervisor with initial, date, and comments.

**c) Report Writing Phase:**

- Write draft audit report with Memorandum (addressed to audit Committee Chair), KRS logo, Executive Summary, detail audit report, applicable appendices, and flowchart or narrative based upon the Fieldwork and work papers. Detail audit report should contain period covered, objective/scope of the audit, in accordance with IIA, reasonable assurance, last day of fieldwork, sampling/testing, activity audited, findings, and conclusion. Detail audit report should be in the format of condition, criteria, effect, cause, recommendation, and overall conclusion.
- Review draft audit report (by supervisor).
- Stamp DRAFT on report and distribute draft report to applicable management and interested parties.

**d) Response of Management and Communication of Final Audit Report:**

- Obtain Management's Response for each recommendation with initial signature, two weeks after the issued date of draft report.

- Attach Management’s Response to the final audit report as an Appendix.
- Sign the final audit report and distribute to the applicable management and interested parties.

**e) Post-Audit Client Survey:**

- Send [Post-Audit Client Survey](#) to Auditee Management for quality purpose.
- Get response of questionnaire in a timely manner.
- Make improvements in next assigned audit.

**f) Documentation:**

- Document all audit work papers, entrance and exit conferences’ results, report, responses, Post-Audit Client Survey, Self-Assessment Quality Control Checklist, and Recommendation Implementation Status Summary (RISS). Add to [Audit Reports Summary Index](#) with all date information.

**g) Preparation for Audit Committee Meeting:**

- Prepare Audit Committee Meeting Agenda.  
One week prior to the Audit Committee meeting, send audit reports and other information to Audit Committee members and Chair.

**h) Follow-up:**

- Follow-up all audit recommendations, management’s response and the status of the implementation of each recommendation.

➤ **Audit Follow-up Procedures**

This procedure outlines for follow-up of recommendation(s) in audit reports issued by the KRS Internal Audit Division and management letters issued by external auditors.

• **Purpose**

To determine that corrective action was taken and is achieving the desired results, or that senior management or the Board has assumed the risk of not taking corrective action on reported observations. To determine the adequacy, effectiveness, and timeliness of actions taken by management on reported engagement observations and recommendations, including those made by external auditors and others.

• **Procedures**

- 1) 90 days after a final report is issued, if Internal Audit obtains management’s oral or written response shows that action already taken and is sufficient when weighted against the relative importance

- of the engagement observation or recommendation then follow-up may be performed as part of the next engagement. Otherwise,
- 2) 90 days after a final report is issued, a copy of the Master Audit Tracking Log will be sent to the individuals whose responses are reflected in the final report. Each addressee will be asked to indicate the status of the recommendations listed on the Master Audit Tracking Log and return it to the Internal Audit Division. For any recommendation not implemented, the auditee will be asked to provide the targeted implementation date, and if not implemented, the reason and a description of any alternate solutions implemented or planned.
  - 3) After the management's written response or the completed Master Audit Tracking Log is received, the Internal Audit Division will verify the implementation status of recommendations related to findings by follow-up audit. However, scheduling of follow-up should be based on the risk and exposure involved, as well as the degree of difficulty, cost and significance of timing in implementing corrective action.
  - 4) For any unimplemented recommendations relating to significant findings, the Internal Audit Division will continue following-up quarterly with the appropriate individuals.

If senior management has accepted a level of residual risk that is unacceptable to the organization and the residual risk is not resolved, the board should be informed of senior management's decision on all significant engagement observations and recommendations.

➤ **Investment Audits/Reviews**

The Compliance Officer will conduct investment audits and reviews following the procedures stated above, except for items (d) and (g). In addition to item (d) the Compliance Officer will obtain the Investment Committee's response to the recommendations, if any, and attach to the report. In addition to item (g) the Compliance Officer will prepare a draft for the Investment Committee to review and obtain comment. A draft will be sent to the Audit Committee with the meeting agenda. A final copy with management and the Investment Committee responses will be provided to the Audit Committee at the next scheduled meeting.

➤ **Outsourced Third Party Audits**

Outsourced third party audits will be approved by the Audit Committee. The findings, recommendations, and management comments will be presented to the Audit Committee for approval, and then ratified by the Board of Trustees.

➤ **Management Requests (Special Audits)**

Management requests (special audits) not on the audit plan shall be forwarded to the Audit Committee Chair for approval. The Audit Committee Chair will determine if a special called meeting of the Audit Committee is necessary to discuss the management request (special audits). If the Audit Committee Chair determines that a special called meeting will not be scheduled, then management requests will be added to the audit plan, and reported to the Audit Committee on the "Status of the Audits Memo" at the next scheduled Audit Committee meeting. The same audit procedures will be followed as stated above.

**Resources:**

- [American Institute of Certified Public Accountants](#)
- [Kentucky Society of Certified Public Accountants](#)
- [Kentucky State Auditor of Public Accounts](#)
- [Kentucky State Board of Accountancy](#)
- [United States Government Accountability Office](#)
- [Government Accounting Research Systems](#)
- [Association of Government Accountants](#)
- [Association of Public Pension Fund Auditors](#)
- [Dean, Dorton, Allen, and Ford, PLLC](#)
- [Governmental Accounting Standards Board](#)
- [Government Finance Officers Association](#)
- [Institute of Internal Auditors](#)
- [The IIA Standards](#)
- [The IIA – Code of Ethics](#)
- [The IIA – Louisville Chapter](#)
- [The IIA – Central Kentucky Chapter](#)
- [The IIA – The Tri-State \(Evansville\) Chapter](#)
- [Kentucky Revised Statutes](#)
- [Kentucky Administrative Regulations](#)
- [Kentucky Personnel Code of Ethics](#)
- [Industry – Different State’s Retirement Systems](#)
- [Audit net](#)
- [Kentucky Records Retention](#)
- [COSO](#)
- [COBIT](#)
- [Audit Dictionary](#)
- [GAIT](#)

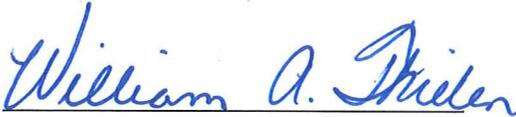
## Approvals

We, the undersigned of the Kentucky Retirement Systems, do certify that this Internal Audit Procedures Manual was approved on November 19, 2015.



Ms. Connie A. Davis, CIA, CGAP, CRMA,  
Internal Audit Director

Date: 11-19-15



Mr. William A. Thielen  
Executive Director

Date: 11-20-15



Brian Thomas  
General Counsel

Date: 11-19-15